No. 1319

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of the Petition of C. K. McINTOSH and JAMES P. BROWN, as Trustees in Bankruptcy of the Estate of A. B. Costigan, Bankrupt

Opening Brief for Petitioners

Upon Petition by Trustees of Bankrupt Estate for Review and Revision of the Decree of the United States District Court for the Northern District of California

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IN THE MATTER OF THE ESTATE OF C. K. McINTOSH AND JAMES P. BROWN, AS TRUSTEES IN BANKRUPTCY OF THE ESTATE OF A. B. COSTIGAN, BANKRUPT

STATEMENT OF CASE.

This is a petition by the Trustees of the estate of A. B. Costigan, bankrupt, for a revision and review under Sec. 24 b. of the bankruptcy act, as amended Feb. 5, 1903. It is for a revision and review of the decision and order of the United States District Court, Northern District of California sustaining the demurrer of the Defendants, the Petaluma Savings Bank et al, to Complainants' amended bill of complaint, on the ground that said amended bill of complaint "does not state a cause of action," and of the final decree, under said decision, decreeing that Complainants take nothing by their said amended bill of complaint, that defendants go hence and for their costs. (See Trans. p. p. 31, 32, 33).

The original bill of complaint and the two subsequent amendments theerto (Trans, p. p. 11 to 24) which constitute the amended bill of complaint, disclose, briefly stated and omitting specific details, that A. B. Costigan of San Francisco, on March 11th, 1903, borrowed from the Petaluma Savings Bank, the sum of Nine Thousand Dollars ($9000.00) for which sum he made and delivered his note to the Cashier of said Bank, D. B. Fairbanks, payable in six months after date with seven (7) per cent interest, and at the same time and at the request and under an agreement with H. T. Fairbanks, President of said Bank, on the 12th day of May, 1903, executed and delivered to said D. B. Fairbanks as security only for the payment of said note, taxes and insurance, several deeds to lands and tenements in the County of Fresno, California, particularly described in the bill of complaint, and as therein averred, on condition that the said lands would be reconveyed and redeeded to Costigan on payment of said note; that Costigan before and up to the time he was adjudicated a bankrupt on Sept. 19th, 1904, was in possession and control of the lands described in said deeds; that said Costigan filed his petition to be adjudicated a bankrupt on the 16th day of September, 1904, and was adjudicated a bankrupt on the 19th day of September, 1904; that three days thereafter, on the 21st day of September, 1904, when title to said lands had vested by operation of law in the petitioners as trustees of the estate of said bankrupt, the said defendants filed said deeds for record with the Recorder of Fresno County; that at the date of said filing for

record they had full knowledge of the insolvency and bankruptcy of said Costigan; that on the 12th of November, 1903, when said note became due and payable and Costigan defaulted in its payment, the defendants with knowledge of facts and circumstances recited in said bill, sufficient to place them on inquiry, and with reasonable cause from such facts to know or believe said Costigan insolvent at that time, still withheld said deeds from record, for ten months after said note became due, and until six days after Costigan had filed his petition in bankruptcy and for three days after he was adjudicated bankrupt; that by reason of these acts and the representations of bankrupt to his creditors and the suppression by Costigan and the defendants of all information as to the existence of these deeds, the other creditors were misled and deceived and gave credit to him and made large loans of money to him and that this failure by defendants to record said deeds for so long a period and the suppression of information in relation thereto gave a false credit to Costigan and operated as a fraud on his other creditors, who are still unpaid; and that within thirty days after said adjudication the trustees filed for record in Fresno County, a certified copy of the decree as required by Section 47 (11) c of the bankruptcy act as amended Feb. 5th, 1903.

ARGUMENT.

The prayers for relief in the original bill and a repetition of those prayers and the recital of additional

prayers in the amendments thereto, which constitute the amended bill, disclose that the character of relief sought is three fold and calls for the exercise of the **summary** powers and jurisdiction of the District Court under Subs. (7), (15), (18), of Section 2 of the Bankruptcy act. These prayers are:

First, that the deeds named be declared adjudged and decreed to be only mortgages executed and delivered only and solely as security, etc. (Trans. p. p. 15).

Second, that said deeds as mortgages recorded by defendant subsequent to the date Costigan was adjudicated bankrupt, were so recorded with knowledge by defendants of the insolvency and bankruptcy of Costigan, and with reasonable cause to believe a preference was thereby intended; and that such deeds as an unlawful preference may be set aside and decreed null and void, etc. (Trans, p. 16).

Third, that the withholding of said deeds from the public records for sixteen months operated as a fraud on the other creditors of Costigan; that the deeds for want of record in order to impart notice are invalid liens on the premises and that the same for such fraud and failure to record may be set aside and cancelled and declared null and void, etc. (Trans. p. 24).

The demurrer interposed by the defendants to this amended bill, is predicated on four grounds.

First, that it does not state facts sufficient to constitute a cause of action, setting forth in the form of argument the reasons. (Trans. p. p. 26 and 27).

Second, that it is ambiguous.

Third, that it is uncertain.

Fourth, that it is unintelligible. (Trans. p. p. 28 and 29).

The District Court sustained this demurrer on the first ground alleged in the demurrer. (Trans. p. p. 31 and 32).

These petitioners for revision and review contend that there is manifest error in the decision and decree of the District Court in sustaining the demurrer on the ground that the complainant's amended bill does not state a cause of action and on the pleadings only entering its final decree in favor of the defendants. (Trans. p. p. 5 and 6).

Preliminary to pointing out the manifest error in holding that this amended bill does not state a cause of action, it is proper to recite the several sources of power and jurisdiction conferred by law on the District Court, and from the definition and elucidation of those provisions by the Supreme Court, arrive at a correct conclusion as to what facts stated in the bill of complaint give it jurisdiction to adjudicate the questions presented.

The District Court has two sources of power and jurisdiction, the one **summary** under Sec. 2 (7), (15), (18), the other plenary under Sec. 23 b. bankruptcy act as amended Feb. 5, 1903.

Under the bill of complaint we were in the form of a plenary suit invoking the summary jurisdiction of the District Court.

This we had the right to do. Neither Congress nor the General Orders in Bankruptcy, adopted by the Supreme Court, prescribe any form of pleadings in Bankruptcy proceedings. The Supreme Court in the recent case of Whitney vs. Winman et al., 14 Am. Bk R. at p. 51, hold that the summary jurisdiction of the District Court may be exercised in a plenary suit under a bill in equity, where the property, as in the case at bar, has come into the possession of the bankruptcy court, subject only to a determination of the validity of liens thereon.

It will be borne in mind that for the purposes of this demurrer the allegation that the bankrupt was at all times in possession of the premises, is admitted to be true and the law (Sec. 70, Bankruptcy act) vests title in and gives possession to the trustees at date of adjudication, Sept. 19th, 1904, and, therefore, this property is in custodia legis and subject to the summary jurisdiction of the District Court under Sec. 2 (7).

Under Sec. 6, of the bankruptcy act of 1841, which contains provisions similar to Sec. 2 (7) of the act of 1898, the Supreme Court in Exparta Christy 3 How at page 314 held, "that while the District Court under Sec. 8 of that act had jurisdiction at law and in equity concurrent with the Circuit Court, the form of the bill did not deprive it of the summary power it possessed under Sec. 6, as that act prescribed no particular form of pleading in bankruptcy proceedings."

The District Court in the case at bar, therefore, under a bill in equity has summary jurisdiction to determine controversies in relation to this property.

The first facts alleged in complainant's bill show that these deeds are simply mortgages and the first prayer of the bill is, that they be decreed to be mortgages.

This is an allegation of fact in relation to property in custodia legis, admitted by the demurrer and over which the District Court has summary jurisdiction.

If, therefore, the District Court had jurisdiction to decree these deeds to be simply mortgages, the bill of complaint did state a cause of action and the demurrer thereto should have been over-ruled and denied.

It has been so repeatedly decided by the Federal Courts that Courts of Bankruptcy have summary jurisdiction to determine the extent and validity of mortgage liens on the property of bankrupts, that it has long since passed beyond the domain of controversy and contention. And it makes no difference whether the property covered by the mortgage is within or beyond the territorial limits of the Courts jurisdiction. The property passes to the trustee subject only to a valid lien.

Markson vs. Heany, 1 Dillon 501.
Exparta Christy 3 How at p. 308.
In re Kellogg 10 Am. Bk. R. at p. 11.
Chauncey vs. Dyke Bros. 9 Am. Bk. R. 447.

It is unnecessary to multiply the decisions by citing the numerous cases under the present law.

The exercise of the summary power and jurisdiction over property subject to mortgage and other

liens, is illustrated in the sales made by the trustee of such property upon the order of the District Court, in the many cases cited in Loveland on Bankruptcy (2 Ed.) Sec. 256, Collier on Bankruptcy (5 Ed.) p. 570.

Sec. 2924, Civil Code of California, provides that "Every transfer of an interest in property other than in trust made only as a security for the performance of another act is to be deemed a mortgage."

Sec. 2925, Civil Code, provides that for the purpose of showing such transfer to be a mortgage it may be proved though the fact does not appear by the terms of the instrument.

Sec. 2927, Civil Code, provides that a mortgage does not entitle the mortgagee to the possession of the property.

It will be seen from these averments of fact in the bill of complaint, admitted by the demurrer and elucidated and explained by the law and the decisions recited, that the bill of complaint in this respect did state facts sufficient to constitute a cause of action, and that the court had summary power and jurisdiction to decree these deeds simply mortgages as prayed for and should have over-ruled the demurrer.

It has been repeatedly held by the Federal Courts, under past and present bankruptcy acts, that proceedings in bankruptcy are in the nature of equity proceedings.

It is a settled rule in equity pleading that "a demurrer to the whole bill must be over-ruled if any part of it is sufficient."

Atwell vs. Ferrett, 2 Blatch 39.
Fed. Case, No. 640.
Heath vs. Erie R. R. Co. 8 Blatch 348.
Brandon Co. vs. Prime 14 Blatch 371.
Livingston vs. Story, 9 Pt. 632.
Whitenack vs. Phil. R. R. Co. 57 Fed, R. 901.

Under our second and third prayers for relief, our contention is that the District Court has summary jurisdiction to determine all controversies in relation to said real estate, the same being in the actual or constructive possession of the trustees and therefore in custodia legis.

Mueller vs. Nugent, 7 Am. Bk. R. 234. 184 U. S. 1.
White vs. Schloerb, 178 U. S. 542.
In re Leed's Woolen Mills 12 Am. Bk. R. 136.
Brandenberg on Bankruptcy, Sec. 577.
In re Reynolds 11 Am. Bk. R. 758.
In re Gibbs 4 Am. Bk. R. 619. 103 Fed. R. 782.
In re Gutnam and Wenk 8 Am. Bk. R. 253.
Whitney vs. Winman, 14 Am. Bk. R. at p. 51.

UNDER SECOND PRAYER FOR RELIEF.

The allegations in the bill of complaint which apply to the second prayer, are covered by the provisions of Section 60 a. b. of the bankruptcy act relating to,

Voidable Preferences.

One of the objects of this bill, though not the only one, is to have these deeds, absolute on their face, but

admitted to be given as security for a debt, declared and adjudged to be an **unlawful preference** under the provisions of Section 60, a, and b, of the Bankruptcy Act, as amended February 5th, 1903.

It will be seen that the allegations of the bill under this head embrace all the essential and necessary averments required by Section 60, a and b, as amended February 5th, 1903, in relation to preferences which **shall be voidable** by the trustee, and under which "he may recover the property."

The defendants make the mistake in assuming that this suit is predicated solely and only on a fraudulent transfer, as covered by Section 67 e or Section 70 e, and that the suit is, therefore, limited in its scope and in the rights and remedies given to the Trustees, by those provisions in Section 67, e, and Section 70, c, of the Bankruptcy Act. In other words, that they must proceed under Section 67, e, and 70, e, and the limitations and specific provisions imposed by the laws of this State in relation to fraudulent transfers, and by the State law, governing the rights of liens and judgment creditors, touching the recording of conveyances and mortgages of real estate.

That this assumption is erroneous and contrary to the express provisions of the bankruptcy law, is apparent, not only from the language of the respective Sections 60, 67, a and d, and 70, applicable to several heads of this case, but is clearly indicated in the latest decisions by the Federal Courts in their elucidation of this provision in Section 60, and 67, a and d, relat-

ing to recordation of the instrument conveying the property or creating the lien.

Prior to the amendment of February 5th, 1903, under which the date of the **transfer** and not the date of **recording,** was made the date of the preference, the contention of defendants as to the date of the preference might have been correct, and the Trustees might not have maintained a suit under Section 60, a and b, **subsequent** to four months from the date of the transfer, but could only proceed under Section 67, e, within four months, or under Section 67, a, under the limitations there imposed, or under Section 70 under the limitations and the State law in regard to fraudulent conveyances.

That part of the amended bill which alleges an **unlawful preference,** and contains other allegations required under Section 60, a and b, needs only to be analyzed by the express language of these subdivisions of Section 60.

From the language employed, and applying the fundamental rule in the construction of remedial Statutes, to-wit, the old law, the mischief and the remedy, it is quite plain that the **preference** was given on September 21st, 1904, for a debt contracted May 11th, 1903, due November 11th, 1903. We will give the language of Section 60, a, as applied to a transfer:

"A person shall be deemed to have given a preference, if, being insolvent, he has within four months before filing the petition * * * made a transfer of any of his property, * * Such period of four

months shall not expire until four months after the date of the recording or registering of transfer, if by law, such recording or registering is required."

To what do the words, "such period of four months," refer? Clearly to the words "given a preference" found in the preceding part of the section.

As I shall presently demonstrate, such recording is **required by law.** It cannot alter or affect the provisions of the section whether its recordation is limited to certain objects and for certain purposes by State law. If its recordation is required **for any purpose,** it must be said that it is "required by law," and for the purposes of a **preference** or its legality under Section 67, a and d, these sections make no exceptions.

Neslin vs. Wells, 104, U. S. 428.

Can the object and intent of Section 60 be defeated by withholding from the records such conveyance, until **after** the petitioning debtor has been adjudicated insolvent and a bankrupt? Certainly Congress did not intend to grant any such immunity to those who recorded **subsequent** to the adjudication, when **title** to and possesion of all the bankrupt's property had vested in his trustee by operation of law, as of that date (Section 70) unless it recognized the correctness of the contention, that title at that date **vested** in the trustee as to all property claimed under an unrecorded instrument. The Federal Courts in some of the cases I shall cite, in which the instrument of transfer was recorded **after** adjudication, have held such recordation to be an unlawful preference.

The date of the deeds and the date of the debt is May 12th, 1903; the date of recording the deeds is September 21st, 1904, about sixteen months after the debt was incurred, ten months after the debt became due, and three days after the debtor, A. B. Costigan, was adjudged **insolvent** and a bankrupt by the judgment and decree of the District Court. Hence, we see, that the preference was given on September 21st, 1904, for an **antecedent debt,** existing since May 11th, 1903, and **over-due ten months.**

It is quite evident that Congress in incorporating this provision into Section 60, by amendment, imposed this disability of an unlawful preference on **secret transfers** of property, the title to which was on the public records and, which, like money and chattels, could not be pledged or transferred by simple delivery in satisfaction of, or as security for, a debt, but would by such public record give a false credit and mislead creditors in their dealings with the insolvent debtor.

The conclusions reached by the Federal Courts in their construction of Section 60 since the amendment of February 5th, 1903, are in harmony with these views:

In the case of English, Trustee, etc., vs. Ross (15 Am. Bk. R. 371), Judge Archibald of the U. S. Dist. Court, Middle Dist. of Pa., in a very able review of all similar cases arising under that section prior to the amendment of February 5th, 1903, points out the distinction between those arising before that amend-

ment, and those arising subsequent, and, in a case similar to the case at bar, expressed an opinion and rendered a decision in harmony with our contention.

The following decisions of Federal and State Courts are in harmony with these views:

Tolman v. Humphry, 12 Am. Bk. Rep. 62 to 65.
Babbett v. Kelley, 9 Am. Bk. Rep. 335.
In re Matthews vs. Hordt, 9 Am. Bk. Rep. at p. 383.
In re Pekin Plow Co., 7 Am. Bk. Rep. 369.
In re Pease, 12 Am. Bk. Rep. at page 72 and 73.
In re Klingaman, 4 Am. Bk. Rep. 256.

The United States District Court, Southern District of Iowa, in construing the law with relation to the time, when an unlawful preference was "committed" under Section 60, held, that, the provisions of Section 3 must be considered in reading Section 60: Also held (See page 258) "It was the purpose of this enactment to declare generally that, with respect to acts of bankruptcy consisting of making transfers of property when insolvent with intent to give a preference, the act is to be held to have been committed when the transfer is made effectual as against other creditors by recording or registering the instrument of transfer." In re Klingaman cited supra.

"Under the provisions of the Code of Iowa, the failure to record the contract of purchase did not affect the validity of the equitable lien as between the parties thereto, and that as no subsequent lien had been obtained against the same up to date when

possession was taken, August 1st, 1899, the lien was effectual as against third parties by the act of taking possession. But the pivotal question **under the bankrupt act is**, when did this transfer take effect as against creditors in the sense that thereby a preference was given to Luthy & Co"? The Court then holds, that, **the preference was given August 1st, 1898, date of taking possession**, and not June 17th, 1898, **the date the agreement of transfer was made.**

Although this decision was rendered before the amendment of February 5th, 1903, it reads into Section 60, the provisions in Section 3, relating to date of recording, a provision now contained in Section 60.

In the case of Landis v. McDonald (88 Mo. App. at page 348), quoting Judge Shiras in the case of Klingaman, cited supra, the Court holds, that, the **preference** dates from the time the instrument of transfer is recorded, and states:

"It makes no difference how valid the mortgage is under the State law, if it is in violation of the specific provisions of Section 60, relating to voidable preference, the mortgage is deemed **a preference**, which may be avoided and set aside by the trustee."

Loveland on Law and Procedure in Bankruptcy (2nd Ed.) p. p. 593 and 594, and notes.

Wager v Hall, 16 Wall, 484.

It is well settled, that the present law, unlike former Acts, does not make the **intent of the bankrupt** necessary to make an unlawful preference.

Black on Bankruptcy, 204 and cases cited.

Under 3rd Prayer for Relief.

Our next ground to determine the **validity** of these admitted mortgage liens is under Section 67, a, which provides, that liens, "which for **want of record or for other reasons,** would not have been valid liens as against the claims of the creditors of the bankrupt, shall not be liens against his estate."

Par. d of this section, clearly indicates, that liens are not valid which are accepted:

1st, "in fraud upon this Act",

2nd," which have not been recorded according to law, if record thereof was necessary **in order to impart notice."**

The complainants bill recites the facts and not mere conclusions of law. These facts as recited show that the deeds were executed May 12th, 1903, and withheld from record until September 21st, 1904, three days subsequent to the adjudication of A. B. Costigan, **insolvent and a bankrupt,** and with knowledge by defendants of said bankruptcy and insolvency.

In paragraphs V and VII of the complainant's original bill (Trans. p. p. 14 and 15), and in par. VI and IX of the amendment thereto (Trans. p. p. 23 and 24) it is alleged "that, the failure to record said deeds misled, and thereby operated as a fraud upon the other creditors of the said A. B. Costigan, who extended and gave credit to him subsequent to

the said 12th day of May, 1903, and prior to the recording of said deeds," and recites facts and circumstances to show the knowledge of defendants and their suppression of information in relation to the existence of these deeds.

Upon these allegations in the bill and under the law applicable to them we have three contentions:

1st. That under the law of this State as under the law of almost every State in the Union, the recordation of deeds and mortgages of real estate is "necessary" for the purpose of "**imparting notice.**"

2nd. That three days before said deeds as mortgages were put on record, **title** to and possession of all the lands described in said deeds had **vested by operation of law in the trustees of the bankrupt's estate,** and that such **title** could not be affected or **divested** by the simple act of a **subsequent** recordation of a mere lien.

3rd. That it was "a fraud upon the act" to withhold the deeds from the public records for almost **one and a half years** after delivery, and for **ten months after debt due,** with the alleged knowledge of facts by defendants, sufficient to put an ordinarily prudent man on inquiry, and thereby mislead and injure other creditors by giving a false credit to the bankrupt.

Our first contention that the recording of these deeds, was, in the language of Section 67, d, **"necessary in order to impart notice,"** is settled by the decision of the Supreme Court in Neslin vs. Wells, 104

U. S. 428, and English, Trustee vs. Ross, 15 Am. Bk. Rep. at p. 378.

In those States where the provisions of the law relating to recording deeds and mortgages of real estate are almost identical with the law of this State it has been held that the object of all recording laws is, "to impart notice." Chief Justice Marshall in Bailey vs. Greenleaf, 7 Wheat, 46.

Section 1213, Civil Code of California, shows that recording is "necessary" in order to give notice of the character of title claimed.

Section 1214, Civil Code of California, provides, "every conveyance of real estate * * is void as against any subsequent purchaser or mortgagee of the same property, * * in good faith and for a valuable consideration, whose conveyance is first duly recorded, and **as against any judgment affecting the title,** &c.

Section 1908, Code of Civil Procedure of California, "the effect of a judgment or final order in an action or **special proceeding,** before a Court or Judge of the State or of the **United States,** &c., * * * is as follows:

In case of a judgment or order against a **specific thing** or in respect to * * * the personal, political or legal condition, etc., of a particular person, the judgment or order is **conclusive upon the title to the thing** * * or the condition or relation of the person.

First then, under the requirements of Section 67, a and d, which pronounce invalid those **unrecorded liens,** where "record is necessary in order to impart notice," and the decisions of the Federal Courts in passing upon these provisions, we contend that the recordation of these deeds, was "**necessary**" in order to "**impart notice,**" that not having been recorded **prior** to September 19th, 1904, the date that A. B. Costigan was adjudicated a bankrupt, that title on that date without notice and therefore free from incumbrance, vested in the trustees under the specific provisions of Section 70, which provides, that the trustee of the bankrupt's estate shall be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, etc., to all, * * *

"Property which prior to the filing the petition he could by no means have transferred" * * *

The admitted allegations of the bill show that the bankrupt filed his petition on the 16th day of September, 1904. Therefore at any time prior to that date he could have transferred said property by deed.

We have no right under this specific provision of the law, with no provisos or expressed exceptions, to **assume** that when such a transfer had been made by the bankrupt, these defendant grantees would have placed their respective deeds on record, before the recordation of a subsequent transfer made by the bankrupt.

The judgment of this Court on the 19th day of September, 1904, adjudicating A. B. Costigan a bank-

rupt, embraced all the elements, and imposed on the bankrupt **and his property** all the conditions contained in the bankruptcy act, and one of these was the **vesting of title** to and possession of all his property in the Trustees, and the disabilities named in Section 67, a, d.

In order to vest this title, it was not necessary as it was under the act of 1867, for the Judge or Register (now Referee) to execute a deed of assignment to the trustees, but title vested, "co-instanti." No conditions are imposed by Section 70 to vest this title. It vested subject to the specific provision of Section 67, a and d. It does not require the recordation of any **instrument of conveyance** in the county where the lands are situate, before title vests; and the allegations of the bill show that the defendants had actual knowledge of the bankruptcy and insolvency of A. B. Costigan at the time they recorded the deeds. The law not only presumes that they had knowledge of the effect of the adjudication of bankruptcy upon the title to said property, but the Supreme Court of the United Sates, and other Federal Courts, have repeatedly held, that the filing of the petition by the bankrupt "was a **caveat** to all the world, and was," in effect an atachment and injunction.

Bank vs. Sherman, 101 U. S. on p. 405.
Meuller vs. Nugent (U. S. Supreme Court) 7 Am. Bk. Rep. p. 234.

And from the date of adjudication, it has been held in many cases under the present act, it is a sequestration of all the bankrupt's property.

From these provisions and decisions, it is apparent, that when the defendants placed these deeds on record, they did so with actual or constructive notice that title and possession by such adjudication had vested in the trustees and that the disabilities of Section 67, a and d, were imposed on their lien; that such judgment was conclusive upon the title to the property as provided in section 1908, Code of Civil Procedure of California, and that the "caveat" and "injunction" created by the proceedings in bankruptcy, made any interference with the title or possession of the trustees or with property in the custody of this Court, subsequent to that date, an illegal and void act on the part of defendants under the provisions of the bankrupt law as elucidated by the Federal Courts.

The provisions of Section 67, a and d, are not found in any previous bankruptcy act, so that decisions under the act of 1841 and 1867, with relation to the character of the title which passed to the trustees, and decisions under the present law predicted on those made under former acts, or looking only as they do at the provisions of Section 70, and not considering the entirely new provisions of Section 67, a and d, have no application to the limitations and disabilities created on liens, and the right and title passing to the trustee under Section 67, a.

In re Thorpe, 12 Am. Bk. Rep. p. 199.
In re Pekin Plow Co., 7 Am. Bk. Rep., at page 373.

It has been too frequently decided to admit of contention, that the trustee represents the creditors and is not confined to rights which were vested in or may be taken advantage of by the bankrupt.

It cannot be said that the State law or State decisions can control, modify or limit the express provisions of the bankruptcy act. So far as they do not conflict, it is settled by the highest judicial authority that the State law and decisions governing property rights shall be followed, but where Congress in the exercise of its Constitutional powers makes any other or different provision in enacting a uniform system of bankruptcy, that provision must prevail.

Section 409, Code of Civil Procedure of California, provides for filing notice of the pendency of certain specified actions, in which the petition in bankruptcy, is not embraced; it then provides, that, "from the time of filing such notice for record only shall a purchaser or incumbrancer of the property affected thereby be deemed to have constructive notice of the pendency of the action, and only of its pendency against parties designated by their real names."

This provision does not and cannot apply to a petition in bankruptcy, as will be seen by a reference to its language. The bankruptcy act does not require the petitioner to perform such an act for "giving notice," and the Supreme Court and other Federal Courts under prior and present bankruptcy acts, have held, that, the filing of the petition is a "caveat to all the world, and an injunction," and that

adjudication operates as a sequestration of the bankrupt's property.

The Supreme Court of the United States in the case of Bank vs. Sherman, 101 U. S. at page 406, in passing upon property rights and the bankruptcy act of 1867 said: The filing of the petition was a "caveat" to all the world. It was in effect an attachment and injunction. On page 405: "The assignment (to the assignee in bankruptcy) related back to the commencement of the proceedings which was by filing the petition on the 23rd day of February, 1875, and the title of the assignee to all the property and effects of the bankrupt became vested as of that date."

The Supreme Court in Meuller vs. Nugent, 7 Bk. Rep., at page 234, says: "It is as true of the present law as it was of that of 1867 that the filing of the petition is a caveat to all the world, and in effect an attachment and injunction, and on adjudication, title to bankrupt's property became vested in the Trustee, (Section 70, 21 c), with actual or constructive possession, and the property placed in the custody of the bankruptcy court."

The vesting of title by operation of law through the **judgment of insolvency and bankruptcy** entered against the bankrupt is certainly not a "conveyance" which may be recorded, but a "judgment" as shown by the recitals in Section 1214, Civil Code of California, and under which judgment title may vest by operation of law as provided in Section 1971, Code Civ. Pro. of Cal.

Now, as Section 409, Code of Civil Procedure, when read with Section 1214 of the Civil Code, provides that the filing of notice of **lis pendens** prior to the recordation of any conveyance of the same property shall render the latter void as against the subsequent **judgment affecting the title**, it follows, that the provisions of the bankruptcy act, and the decisions of the Federal Courts, that the filing of the petition operates as a caveat to all the world and an injunction against all persons; in other words, a notice to all the world and a restraint upon all persons seeking to interfere with the title or possession, fulfills the requirements of **notice of the pendency of action**, which by the subsequent **judgment** prior to the recordation of defendant's deeds, impressed such deeds with the disability named in Section 1214, and made them void as against the judgment of the District Court adjudicating A. B. Costigan a bankrupt.

It cannot be said, that all the provisions of a State law, and all the decisions of its courts must be followed in order to effect title to property. The State law provides **the manner** of transferring and conveying title to real estate, not confining it to deeds of conveyance, but embracing a provision for title vesting by operation of law (Sec. 1971, Code Civ. Pro.). No one questions the power of Congress by the provisions of the bankruptcy law, nor the power of its Courts in elucidating that law, to prescribe and determine what shall constitute a notice equivalent to that prescribed in Section 409, Code of Civil Procedure of California.

If it were necessary many decisions by the Federal Courts could be cited in which the provisions of the bankruptcy law, and the absence of applicable provisions in the State law, imposed on them the judicial duty of prescribing a different rule in property rights, than those fixed by State law, and judicially determined by State Courts.

But while the provisions of Sec. 409, Code of Civil Procedure of California, is a rule of action for State Courts, it does not effect title or rights or liens acquired by the judgment or decree of Federal Courts.

In the case of Restherglen vs. Wolf et al. (Federal Case No. 12,175) the Circuit Court for the E. D. of Va., held, that a lis pendens in a U. S. Court binds property in litigation though not recorded and docketed as required by State law if in a State Court.

To the same effect are the following cases, in which the filing and recording of notice of lis pendens is required by the State law, but the Federal Courts held, that this requirement only applies to cases pending in the State Courts.

U. S. vs. Humphreys, 3 Hughes 201, Federal Case 15,422.

Shrew et al. vs. Jones, Federal Case No. 12,818.

"The adjudicating of bankruptcy was equivalent to the commencement of an action and the filing of lis pendens." In re Kellogg, 10 Am. Bk. R. at page 12, line 30.

It must be remembered in the consideration of the case at bar, that it is not a question of the priority

of liens, the one predicated on an unrecorded mortgage, and the other on a general judgment operating only as a lien, but that the question presented by the admitted facts is, whether title once vested in trustees, by a judgment in rem, (as distinguished from a judgment that simply creates a lien) can be divested or impaired and destroyed by a subsequent recordation of the mortgage lien.

This title is vested in the trustees for the benefit of the creditors, and as the Federal Courts here repeatedly held, the trustee takes and is invested with more than the rights and titles of the bankrupt.

They are invested with every right and secure in every title, with which any creditor could have been invested or secured by a judgment giving such creditor title "by operation of law" before the mortgage lien had been recorded. Can it be said that if this judgment of Sept. the 19th, 1904, had vested title in a creditor of A. D. Costigan, that such title "by operation of law," created by such judgment, could have been divested or impaired by recording this mortgage lien three days subsequent thereto? If so, what becomes of the provision of Sec. 1214, Civil Code of California, which declares such unrecorded mortgage void "as against any judgment affecting the title"? And if a mortgage, thus withheld from record for sixteen months, may be recorded three days after title vests under a judgment, why may not a mortgage withheld from record for five years be recorded five years after vesting of title in a trustee in bankruptcy or in any one securing title by operation of

law? Sec. 67 of the bankruptcy act, prescribes no period of limitation, therefore to favor the short and disfavor the long period would be simply "judicial legislation."

That these contentions on behalf of the vested rights of the trustees under Sec. 67, a and d, are justified by the latest decisions of the courts, State and Federal, in their construction of that section, the following authorities will show:

In re Lukens 14 Am. Bk R. 683. 138 Fed. R. 188.

In the case of Lukens, just cited, Judge McPherson held that "a mortgage recorded or unrecorded is a mere security for money and gives a lien but not an estate in the ordinary sense of the word; that Section 67 a of the bankruptcy act, states an exception to the rule that the trustee takes no better title than the bankrupt himself possessed; and it states such an exception because it forbids the holder of an instrument who might have had a lien if he had recorded it before bankruptcy to acquire such a lien by recording it afterward." * * *

"It seems to me that Congress intended to say **inter alia** to such creditors, if from lack of diligence you have failed to record your mortgage before the beginning of bankruptcy proceedings, you shall not acquire a lien afterwards although you do record it then."

The decision of Judge McPherson relates to a mortgage on real estate in the State of Pennsylvania

where the provisions of the recording acts do not differ materially from Sec. 1214, Civil Code of California, as will be seen by reference to his decision.

In California as in Pennsylvania, it is the settled doctrine that a mortgage is a mere security for a debt and passes only a chattel interest; that the mortgage constitutes simply a lien or incumbrance, and that the land subject only to this lien, may be sold and conveyed by the mortgagor.

McMillan vs. Richards, 9 Cal. 365.
Carpenter vs. Brenham, 40 Cal. 221.
Bludworth vs. Lake, 33 Cal. 255.
Harp vs. Callihan, 46 Cal. 222.
Tapia vs. Demartini, 77 Cal. 386.
Stewart vs. Powers, 98 Cal. 514.

"A deed absolute on its face, but intended merely to secure an indebtedness of the grantor to the grantee, is a mortgage and does not convey the title to the land." Moesant vs. McPhee, 92 Cal. 76.

Farmer vs. Gross, 42 Cal. 169.
Lodge vs. Turman, 24 Cal. 385.
Montgomery vs. Spect, 55 Cal. 352.

"A deed absolute on its face, given to secure payment of a promissory note, is a mortgage and does not convey title nor give the right to possession of the mortgaged premises to the mortgagee," Raynor vs. Drew, 72 Cal. 307.

The case of Lukens, cited supra, it will be observed is analogous to the case at bar. It relates to a deed

or mortgage of real estate recorded after adjudication of bankruptcy, and therefore after title had vested in the trustee by operation of law. In the large number of cases arising under the same provision of the law, it will be found that the instrument of transfer or mortgage was recorded before adjudication and **before** title had vested in the trustee, but within four months of such adjudication. In such cases it was not the divesting or impairment of a vested title by recording a simple mortgage lien, but a conflict as to the rights of **simple contract creditors** under State laws, in their assertion of title in the trustees against a mortgage or other lien recorded **before** the bankrupt filed his petition or was adjudicated a bankrupt.

But in all the cases having all or a part of the essential elements apparent in the case at bar, the decisions have been in harmony with the late case of Lukens cited supra.

In re Thorp, 12 Am. Bk. R. 195.
In re Booth's Estate, 98 Fed. 976.
Chesepek Shoe Co. vs. Seldner, 122 Fed. R. 593.
In re Shirley, 7 Am. Bk. R. at p. 302.

It is apparent from the law of California that the recordation of these deeds is "necessary for the purpose of imparting notice."

Sec. 1213, Civil Code Cal.
Sec. 1171, Civil Code Cal.

In Cady vs. Purser, 131 Cal., the Supreme Court held (at page 556): "If the grantee of an interest

in lands would protect himself against subsequent purchasers or incumbrancers he must **give notice** of his interest, and as the Statute provides for constructive notice instead of actual notice, it is incumbent on him to comply with all the requirements prescribed for such constructive notice, one of which is the correct transcription of the instrument into the appropriate book."

And at page 557: "When the recording of the instrument is the means by which his ultimate purpose is to be carried into effect, as when **his purpose** is to give notice of his **interest** in real estate, Section 1213, Civil Code, requires not only that the instrument shall be filed with the recorder for record, but also that it shall be "recorded as prescribed by law."

In this case the Court held that where the mortgagee failed to properly record his mortgage until **after** a third person had **acquired an interest** in the land it was void as to such third person. (See at page 559.)

At page 560: "A title may be paramount and superior to the title of the mortgagee, although acquired **after the date of the mortgage.**" The provisions of Section 1214, C. C., by which the failure of the mortgagee to record his mortgage renders it void as against subsequent purchasers and mortgagees, deprived it of all consideration in **reference to its date,** and required it to be treated as if it had been executed **subsequent** to the record of the **subsequent** purchaser. Being void as against him, neither its date nor its contents can be available to defeat his title."

To the same effect Neslin vs. Wells, 104 U. S. 428.

In Odd Fellows Savings Bank vs. Banton, 46 Cal. 607, the court citing Sections 1213-1214 and 1215, C. C., held:

"It is apparent from these sections that the legislature intended that **all instruments** within the definition of a conveyance, in any manner affecting the title to real property, should be filed for record in the proper Recorder's office, and until so filed should be void as against all persons who subsequently without notice, in good faith and for a valuable consideration, might acquire any interest therein either as purchasers or incumbrancers."

The questions presented by provisions of Sections 67 a and 70, is as to the **vesting of title,** and not to **priority of liens,** as determined by the Supreme Court in Bank of Ukiah vs. Petaluma Savings Bank, 100 Cal., 520. The judgment **vesting title** in the trustee cannot therefore be confounded with a simple **judgment lien.** Nor can that decision, nor the decision in Root vs. Bryant, 57 Cal. 48, that a mortgage lien attaches when the instrument is executed though recorded afterwards, affect the provisions of Section 67, a and d, of the bankrupt law, nor the effect of failure to record as provided in Section 1214 Civil Code. It is doubtless good **between the parties** and as against those who acquire no rights or interests in the premises **prior to recording.**

It is true that Section 47 (11) c, bankruptcy act, provides: "The trustee shall, within thirty days after the adjudication, file a certified copy of the decree

of adjudication in the office where conveyances of real estate are recorded in every county where the bankrupt owns real estate not exempt from execution"; * * *

It has been repeatedly held by the Courts, in every State where a period is named in the law within which a deed or mortgage may be recorded, that such deed or mortgage if recorded within that period or on the last day of that period, is good, and the title or lien given by such instrument is not effected or postponed by the prior recordation of any other deed or mortgage wthin, but before the expiration of the period allowed by law for such recordation. In other words, it has been said, that if the law allows thirty days in which to record an instrument, its recordation within that thirty days, relates back to its date, and makes its record effectual from the date of the instrument.

Clark vs. White, 12 Pet. at page 197.

Under this rule, the recording of the decree of adjudication of bankruptcy as alleged in complainant's amended bill makes such recordation effective on the 19th day of September, 1904, three days before defendants filed their respective deeds for record.

In addition to the disability imposed by Sec. 67 a on mortgage and other liens, "for want of record," that section also provides that if such claims "**for other reasons**" would not have been valid liens against the claims of creditors of the bankrupt they shall not be leins against his estate."

We, therefore, contend, under this provision of Sec. 67 a, when read in connection with Sub. d of that section, that we may allege, and have alleged facts in par. V and VII of the original bill (Trans. p. p. 14-15) and par. VI and IX of the amendment thereto of June 24, 1905 (Trans, p. 21 and 22), showing,

Constructive Fraud.

Our contention under this head, embraced in and covered by our 3rd prayer for relief, is, that the defendants have been guilty of constructive fraud; that a deed or mortgage, not at first fraudulent, may afterwards become so by being concealed, or not pursued, by which means creditors are deceived and lend their money or give credit so that a mortgage lien which was not at first fraudulent may become so through such concealment; that added to this is the fact that the deeds did not when made or recorded express the truth, and when such a deception is added to the long concealment, it is generally held to be a badge of fraud, because it affords a convenient cover for fraud upon creditors.

This contention is sustained not only by the provisions of the Code of this State but by the highest judicial authority, in cases analagous to the one under consideration.

Blenerhassett vs. Sherman, 105 U. S. 118 to 122.

This was the case of an unrecorded mortgage under the bankruptcy act of 1867, which did not contain

the specific provisions of Section 67, a and d, and therefore was not as strong a case as the case at bar. In that case the Court held: (See page 118.)

"A deed of trust in the nature of a mortgage, valid on its face and not made or received with any intent to defeat existing or future creditors, may nevertheless be held to be **fraudulent and void** as to all creditors, existing and future, by evidence aliunde, showing the conduct of the parties, &c. The **principal circumstance** relied on in this case to avoid the deed was the fact that the **grantor retained possession** of the property and the deed was withheld from record, and the mortgagor was thereby enabled to contract **debts** upon the presumption that the property was unincumbered, the Court declared that the **natural and logical** effect was to mislead and deceive the public, and induce credit to be given to the mortgagor, which he could not have obtained if the truth had been known, and therefore the whole scheme was fraudulent as to subsequent creditors, as much as if it had been conceived from that motive and for that object."

Page 122: "If the mortgage (on land) had been executed within the period of two months (Act of 1867) next before the filing of petition in bankruptcy, it would have been void under the letter of the bankruptcy act. When all the other circumstances necessary to render it void concur, the device of concealing it until the two months have elapsed cannot save it. It is, notwithstanding the lapse of time a fraud on the

policy and objects of the bankruptcy law, and is void as against its spirit."

Same effect in Hillard vs. Coyle, 46 Miss. 309. Hildeburn vs. Brown, 17 B. Mon (Ky.) 779.

In State Savings Bank vs. Buck, et al., 123 Mo. 141, held: (Under the law of Mo. parties are not required to record their mortgages, except to "impart notice".) "Two deeds, absolute in form were given by Buck to the Bank, one in November, 1884, one in November, 1885, as security for the loan of $9000, value of property $13,000; they were not recorded until November, 1887, two or three years after respective dates. On that date Buck and partner, McCloskey, failed and made a voluntary assignment for benefit of creditors, etc. The Chief Justice, among other things, says: "There is no claim made that the failure to record them was through any oversight or neglect; they were certainly withheld by design, and we cannot escape the conclusion that they were not recorded because of some understanding to that effect. In this the parties were not actuated by any **actually fraudulent purpose** or evil design to injure the creditors of Buck & McClosky.

"The title of a bona fide grantee or mortgagee is good against creditors at large of the grantor or mortgagor though the deed or mortgage is not recorded. A person incurs no penalty for a mere failure to record his deeds, save such conveyances as are provided for by the recording acts; and the mere failure to record a deed or mortgage, is not evidence

of fraud, unless there is an agreement to deceive others, or it has that effect."

"It was held long ago that a deed not at first fraudulent, may afterwards become so by being concealed, or not pursued, by which means creditors are drawn into lend their money."

Citing Hungerford vs. Sands, 2 Johns Ch. 35.

"A deed not at first fraudulent, may become so by being concealed, because by its concealment persons may be induced to give credit to the grantor. In such cases the use that is made of it, relates back and shows the intent with which it was made. The omission to place a deed on record, or leaving it in hands of grantee, &c., to be produced or suppressed accordingly as exigencies may demand, are instances of secrecy that are within the rule."

Citing:

Bump on Fraudulent Conveyances (3 Ed.), page 39.

"There are many cases where the existence of an intent to hinder, delay and defraud is not a question of fact, but is one of law." Every man is presumed to intend the necessary consequences of his act, and if an act necessarily delays, hinders or defrauds creditors, then the law presumes that it was done with a fraudulent intent.

Citing:

Bump on Fraudulent Conveyances (3 Ed.), page 22.
Wait on Fraudulent Conveyances and Creditors Bills (2 Ed.), Section 9.

(The Chief Justice quotes many other cases in Mississippi, Missouri, Wisconsin and England of the same character.)

In conclusion he says:

"In applying these principles of law to the case in hand it is to be observed, in the first place, that these deeds did not, when made or when recorded, express the truth, though a deed absolute on its face may be shown to be a mortgage, still, such a conveyance is generally held to be a **badge of fraud,** because it affords a convenient cover for fraud upon creditors.

"The result of withholding of these deeds from record for the long period was to give defendant a false financial standing and to mislead and deceive the creditors, and the plaintiff must be held in law to have intended that result, though actuated by no fraudulent or evil motive. The deeds must be held fraudulent as to defendants."

To the same effect:

Hildreth vs. Sands, 2 John (N. Y.), Ch. 35.
Scrivener vs. Scrivener, 7 B. Mon. (Ky.) 374.
Bank of U. S. Houseman, 6 Page (N. Y.) 526.
Coats vs. Gerlach, 44 Pa. St. 43.

The case of Neslin vs. Wells, 104 U. S., 428, is strongly in point.

"This case arose in the Territory of Utah, where the law permitted, but did not **require,** the registration of mortgages, but where there was a **general custom** to record such instruments. Neslin, the vendor of land, took from Smith, his vendee, a mortgage to secure a part of the purchase money, but did not file it for record until after a subsequent mortgage executed by the vendee on the same land, to one Kerr, had been filed for record, Kerr having no notice, actual or constructive, of the prior mortgage to Neslin. It was held by the Court, that, "under the circumstances of the case there arose **a duty** on the part of Neslin, the vendor, **to record** his purchase-money **mortgage,** towards all who might become subsequent purchasers for value in good faith, a breach of which duty in respect to Kerr the **subsequent** mortgagee, without notice constituted such negligence and laches **as in equity requires**, that the loss which in consequence thereof must fall on one of the two, shall be borne by him by whose fault it was occasioned."

There are several provisions in the Codes of this State, which are in harmony with, and justify the application of these decisions to the case at bar.

Section 1573, Civil Code. "Constructive fraud consists:"

1. "In any breach of **duty,** which, without an actually fraudulent intent, gives an advantage to the

person in fault. * * * by misleading another to his prejudice, or to the prejudice of any one **claiming under him.**"

It certainly was a breach of duty imposed alike by law and in equity for these defendants to withhold from the records **for so long a period** the secret deeds held by them. I have cited the case of Neslin vs. Wells, where it is held that recording **is a duty** and the provisions of the Code which impose **the duty** of recording in order to "**impart notice.**"

Add to this the familiar maxim as old as our jurisprudence, and embodied in our Civil Code, (Section 1963, par. 3) "that a person intends the ordinary consequences of his voluntary act."

See also Loveland on Bankruptcy (2 Ed.), page 580.

In the case at bar as set forth in paragraph VI, VII and IX of the bill, and as held by the Supreme Court of the United States and by the Court in the case of State Savings Bank vs. Buck, et al., cited supra, the ordinary consequence of the defendants voluntary act, was to mislead the creditors of the bankrupt and induce them to give the bankrupt credit.

The rule at law is quite different from the rule in equity.

Judge Story states the rule Vol. I "Equity Jur. Sec. 187," thus: "Fraud in deed in the sense of a court of equity, properly includes all acts, **omissions** and **concealments** which involve a breach of legal or

equitable duty, * * * * * * and is injurious to another, or by which an undue or unconscientious advantage is taken of another."

In the case of Brady vs. Bartlett, 56 Cal. at page 366, the Court says, that, the definition in the Code, Section 1572 and 1573, substantially accord with the rule above stated, and that fraud arises out of a **breach of duty** or obligation.

Sukeforth vs. Lord, 87 Cal. 400.

"A man is guilty of fraud in doing what the law deems fraudulent, although he may not be conscious that he is committing any wrong."

Id. p. 503.

"Even when there is no intention to deceive, there may be such amount of gross carelessness as to constitute conclusive evidence of a fraudulent intent."

Alvarez vs. Brannan, 76 Cal. 503.

In Wager vs. Hall, 16 Wall, at page 601, it is held: "A transfer by insolvent debtor within four months **is a fraud** on the bankruptcy act, and void, * * * Positive proof of fraudulent acts between debtor and creditor is not generally to be expected; the law therefore allows a resort to circumstances as the means of ascertaining the truth," &c.

"Knowledge of a given fact, may be proved by circumstances, even in an ordinary suit." Page 602.

As a summary of our contentions we reiterate, that the allegations of fact in the amended bill were suf-

ficient to constitute a cause of action under the summary jurisdiction of the District Court.

1. To declare these deeds, mortgages, under Sec. 2 (7).

2. To declare the deeds, "an unlawful preference" under Sec. 60, a and b.

3. To declare the deeds, unrecorded at date Costigan was adjudicated bankrupt void, under Sec. 67, a and d.

4. To declare the deeds "constructively fraudulent," and therefore void, under Sec. 67, a and d.

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